

Alert

CFTC Proposes Broader Relief for Commodity Pool Operators

October 16, 2018

On Oct. 9, 2018, in a wide-ranging notice of proposed rulemaking (the “KISS Proposal”¹), the Commodity Futures Trading Commission proposed (1) to codify several accepted practices that currently rely on no-action letters and similar CFTC staff guidance and (2) to make a number of substantive changes to CFTC regulations, such as offering broader exemptive relief for offshore funds and imposing disqualifications from certain commonly claimed exemptions.²

The proposals are now in a comment period, so investment managers that (1) are CFTC registrants, (2) are claiming one or more exemptions from CFTC registration or (3) operate funds that are claiming one or more exemptions under the CFTC’s regulations should review the proposals to determine what, if any, changes the KISS Proposal would have on their businesses. Some managers may deem it useful to submit comment letters to the CFTC explaining what the effect of these regulations, if adopted, would be on their businesses.

1. Commodity Pool Operator Exemptions for Non-U.S. Funds

One of the most notable proposals focuses on non-U.S. commodity pools. Currently, commodity pool operators (“CPOs”) to funds that are made available only to non-U.S. investors may be eligible to claim two exemptions:

1. Rule 3.10(c)(3)(i), which provides a full exemption from CPO registration for a CPO located outside the United States that engages in commodity interest transactions “only on behalf of persons located outside the United States,” and
2. Advisory 18-96, which provides an exemption to registered CPOs from most, but not all, of the reporting and disclosure requirements for foreign pools (note that CPOs of 18-96 funds are still required to file the Form CPO-PQR).

¹ In 2017, CFTC Chairman Giancarlo launched Project KISS (“Keep It Simple Stupid”), an agency-wide review of CFTC regulations and practices, with the overall objective of applying existing requirements in ways that are simpler, less costly and less burdensome.

² *Notice of Proposed Rulemaking: Registration and Compliance Requirements for Commodity Pool Operators and Commodity Trading Advisors* (Oct. 9, 2018), available [here](#).

The KISS Proposal would replace 18-96 with a new Rule 4.13(a)(4), which would serve as an exemption from substantive CFTC reporting requirements, including CPO-PQR, and — unlike 18-96 — can operate both to permit qualifying unregistered CPOs to remain exempt from CFTC registration as well as to eliminate, for registered CPOs, reporting obligations for qualifying commodity pools.³ It would, however, require that:

- As with 18-96, the funds operated by the CPO have no U.S. persons as investors;
- Unlike 18-96, the funds would have to satisfy an additional requirement that no capital be contributed directly or indirectly from a source in the United States;
- Disclosure language be provided to investors concerning the lack of CFTC oversight and the basis for the exemption being relied upon (similar to what is required under current Rule 4.13(a)(3)); and
- A notice be filed with the National Futures Association and be reaffirmed annually.

It is also important to note that the proposed Rule 4.13(a)(4) retains the 18-96 requirement that a fund not hold meetings or conduct administrative activities within the United States.⁴

2. Statutory Disqualifications from Rule 4.13(a)(3)

The CFTC is also proposing to apply a statutory disqualification provision, which is currently found in 18-96, to all Rule 4.13 exemptions (other than the family office exemption), including current Rule 4.13 exemptions such as the Rule 4.13(a)(3) de minimis exemption.

This would mean that any individual or entity claiming a Rule 4.13 exemption, with limited exceptions already present in Advisory 18-96, will need to represent that none of that person or any of its principals is subject to any statutory disqualification under Sections 8a(2) or 8a(3) of the Commodity Exchange Act. The exceptions would permit statutory disqualifications that were previously disclosed in registration applications that were granted, or that were disclosed more than 30 days prior to the claim of exemption. Firms that already have made Rule 4.13 filings would need to satisfy this new requirement in a reaffirmation; CPOs filing new claims of a Rule 4.13 exemption would be required to comply with the prohibition upon filing, if and when the CFTC's proposal is adopted and effective.

3. Codifying Existing No-Action Letters

The CFTC also proposed to codify several no-action letters that provide CPO registration or reporting exemptions or relief from other requirements. Although there were minor adjustments, the KISS Proposal generally proposed to codify these letters in substantially the same manner.

There are still certain letters related to CPO exemptions that currently remain effective but were not included in the KISS Proposal.⁵

³ Similar to the Rule 4.13(a)(3) "de minimis exemption," proposed Rule 4.13(a)(4) would be available both to a CPO as a full exemption from CFTC registration, or for a CFTC-registered CPO with respect to certain obligations in respect of its non-U.S. funds.

⁴ This provision has historically limited the applicability of 18-96 for certain U.S.-based CPOs, particularly firms who appoint at least one "insider" director to the fund who works out of the main U.S. office of the CPO.

⁵ See [CFTC Letter 12-38](#) (Funds of Funds); CFTC Letters [12-14](#), [12-45](#) and [12-67](#) (Securitization Vehicles); CFTC Letters [14-113](#) (Insurance Companies); CFTC Letters [12-13](#) and [12-44](#) (REITs).

SEC Rule 506(c) Harmonization. In 2014, the CFTC staff granted broad relief intended to remove an obstacle to the ability of market participants, under rules previously promulgated by the U.S. Securities and Exchange Commission and now incorporated into Regulation D under the Securities Act of 1933 as SEC Rule 506(c), to utilize general solicitation and general advertising in conducting private placements.⁶ The KISS Proposal largely tracks the relief provided by the earlier no-action letter by proposing to remove the language prohibiting general solicitation from both Rule 4.13(a)(3) and Rule 4.7; *provided* that a fund is offered in compliance with Regulation D (including Rule 506(c)). However, unlike the current no-action relief, the KISS Proposal is not proposing any type of notice filing.

CPO-PQR and CTA-PR. In 2014 and 2015, the CFTC staff granted no-action relief for registered CPOs and commodity trading advisors (“CTAs”) that only operate or advise exempt accounts (e.g., a CPO that elects to register with the CFTC but only operates Rule 4.13(a)(3) funds,⁷ or a CTA that does not direct trading for any commodity interest account⁸) from the requirement to file CPO-PQR and CTA-PR, respectively. The KISS Proposal includes proposed revisions to Rule 4.27 that would codify both of these relief letters.

Family Offices. Prior to 2012, many family offices either relied on the “old” (and since rescinded) CFTC Rule 4.13(a)(4) or on one of several CFTC staff interpretive letters that provided scenarios in which family offices would not be deemed to be commodity pools. In 2012, in response to the rescission of old Rule 4.13(a)(4), the CFTC staff provided CPO registration no-action relief for operators of “family offices,”⁹ as well as, in 2014, similar relief to CTAs to family offices.¹⁰ The KISS Proposal proposes to codify these relief letters as new Rule 4.13(a)(8) and Rule 4.14(a)(11), respectively, for firms providing advice to and operating clients that are “family offices” as defined in Rule 202(a)(11)(G)-1(b) of the Investment Advisers Act of 1940.¹¹

As with other Rule 4.13 exemptions, the proposed Rule 4.13(a)(8) would require a notice filing be made (through the NFA’s website).¹² While the CFTC did not propose to extend the statutory disqualification provision to proposed Rule 4.13(a)(8), it would require the proposed Rule 4.13(a)(8) exemptions be reaffirmed annually.¹³ As with most other Rule 4.14 exemptions, the proposed Rule 4.14(a)(11) exemption would be self-executing.

⁶ See [CFTC Letter 14-116](#).

⁷ See [CFTC Letter 14-115](#).

⁸ See [CFTC Letter 15-47](#).

⁹ See [CFTC Letter 12-37](#).

¹⁰ See [CFTC Letter 14-143](#).

¹¹ The CFTC noted that family offices that cannot meet the requirements of the proposed exemptions may, if they qualify, still seek relief provided in Rule 4.13(a)(3), or they may continue to seek relief on an individual, firm-by-firm basis through requests submitted to CFTC staff.

¹² Unlike CPO relief provided to others such as business development companies and funds of funds, family office notice filings pursuant to CFTC Letter 12-37 are not made available to the public via the NFA BASIC database. The CFTC is requesting comment regarding whether Proposed 4.13(a)(8) filings should be provided the same treatment.

¹³ The CFTC did request comment as to whether this would be appropriate.

If this rule is finalized as proposed, most family offices that currently rely on the family office interpretive letters would be able to continue to do so.¹⁴ However, family offices that have previously filed for relief under CFTC Letter 12-37 would need to make a new notice filing via the NFA's website and reaffirm that exemption annually.

Business Development Companies. In 2012, the CFTC also provided no-action relief to the operators of business development companies (such as the investment adviser) from CPO registration. This was necessary because, in 2012, many business development companies came to be considered commodity pools due to the addition of "swaps" to the definition of "commodity interest." While the CFTC provides a de minimis exclusion, under Rule 4.5, for registered investment companies, a business development company is not a registered investment company; it is *merely exempt from registration* as a registered investment company. The CFTC is now proposing to codify the 2012 no-action relief by revising the language of Rule 4.5's registered investment company exemption to also incorporate business development companies. Under the KISS Proposal, business development companies would be required to reaffirm their Rule 4.5 exclusion on an annual basis.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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¹⁴ In the CFTC's adopting release rescinding old Rule 4.13(a)(4), the CFTC confirmed that the Family Office Letters are interpretive letters that may be relied upon by other persons in addition to the beneficiary of the letter. *See* Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 FR 11252, 11263 (Feb. 24, 2012); correction notice published at 77 FR 17328 (March 26, 2012).